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UNCLAS SECTION 01 OF 02 SAN SALVADOR 002572

SIPDIS

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E.O. 12958: N/A
TAGS: ECON ETRD KTEX ES CAFTA
SUBJECT: TEXTILES AND APPAREL SECTOR: UPDATED STATISTICS AND PROJECTION OF FUTURE COMPETITIVENESS WAITING FOR CAFTA

REF: STATE 146213

¶1. SUMMARY: This is in response to reftel. El Salvador's economy continues to be highly dependent on the textile and apparel industry, which represents a substantial portion of total industrial production, exports and employment. The sector, which has been crucial to the government's development plans in the past, is suffering the effects of the post quota era, and investment and employment levels have begun to drop. CAFTA could help reverse this situation and reinvigorate the sector by increasing the attractiveness of investing in El Salvador, but to date investors have not committed to significant new investments. END SUMMARY.

¶2. El Salvador's total industrial production was $3.61 billion for 2004 and $951 million in the first quarter of ¶2005. Of that amount, textile and apparel production accounted for $469 million in 2004 and $123 million in the first quarter of 2005. Textiles imports as a percentage of total imports went from 22% in 2004 to 20.9% in the first semester of 2005, whereas and exports of textiles and apparel went from 55.2% of the total in 2004 to 50.8% in the first semester of 2005. The total number of industrial jobs was 423,418 in 2004, . As of May 2005 the textile and apparel industry accounted for approximately 70,000 jobs. at year-end(?).

¶3. There are no reports from the Salvadoran Garment Association (ASIC) that local companies are receiving lower prices for their orders, but thatthey do report that companies are receiving fewer total orders. This situation has accounted for the closure of 6 companies in 2004 (6,000 direct jobs lost) and, 7 in the first quarter of 2005 (5,000 direct jobs lost). An additional and 5 more maquilas have temporarily suspended operations while they wait for new orders. Comment: Original projections of conditions in El Salvador's textile/apparel sector in the post-quota world (reftel) were harsh. Government officials told Emboffs on September 13 that they may have been overly pessimistic, claiming that the sector has stabilized and that maquila exports had actually increased by 1% as of August over the same period last year. End comment.

¶4. The Ministry of Economy has made keeping textile and apparel activity going in El Salvador a key element of its large part of its economic strategy for the near term. For its part, PROESA, the government's investment promotion office, has been working hard, with limited resources, to attract new investment to the sector. El Salvador's Vice President, who is the titular head of PROESA, will lead an iIt is sponsoring an investment promotion tour of eight U.S. cities over the next year, the United States, thea first focus of which will be the apparel industry in South Carolina. No new construction has started , however, as the companies wait for CAFTA's implementation and to find out what sorts of incentives the GOES can will provide. The GOES wants to support the training and energy needs of targeted businesses, but resources are so limited that they can only effectively offer these incentives to half a dozen companies.

CAFTA

¶5. The GOES and the textile sector have great expectations that CAFTA and the possible textile agreement between the US and China will be the key to reverse the current downward trend. Such a reversal will only come if it prompts US customers to look to Salvadoran factories to provide full-package services with locally sourced fabric that require more value added service (currently the value added services represents only 20.77% of total maquilas exports). If textile mills decide to invest in El Salvador, the sector could gain a competitive advantage and send a positive sign for other companies to expand operations, enhancing the opportunities provided by CAFTA..

Labor Commitments Under CAFTA

¶6. As a result of the commitments taken by the GOES in the

framework of required by CAFTA, in March 2005, the Minister of Labor Jose Roberto Espinal Escobar and Acting Minister of Economy Blanca Imelda Jaco de Magaa signed an Agreement of Understanding to eEstablish iInteragency Ccoordination rRegarding the Eenforcement pProcedure of the Industrial Free Trade Zone Law. This agreement requires that the Inspector General of Labor and the Directorate of Commerce and Investment will to exchange periodically periodically information and will keep a shared database of the free trade industries that are not fulfilling labor standards, according to article 31 of the Free Trade Zone law. .
¶7. Comment. CAFTA will increase the attractiveness of investing in Central America, but it will not guarantee that the investment comes specifically to El Salvador. in particular. For El Salvador to make the most out of CAFTA and compete in the post quota era, it must have more than geographic proximity to the U.S., and a number of factors must come together at the same time. The industry must learn more about regional production capabilities and find its a niche, probably in providing higher value full package production and just in time delivery of product;. banks must support the large investments necessary to expand capacity; and the government must provide an attractive environment for new investment.; Pprivate business must leverage every competitive advantage (qualified labor, geographic proximity, adequate infrastructure);. and Ssmall and medium sized companies must have access to technology to allow them to change production lines quickly to meet market demands. Post believes that the GOES has invested too much in the industry to see it fail, however they have not revealed a broad package of incentives to promote the industry. At this time current operators and possibPossible investors seem are still to be waiting to see the affects of CAFTA and what incentives the GOES will provide to take advantage of it., so the industry will not see any improvement in the short term. End Comment.

Barclay